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In The

SUPREME COURT OF THE UNITED STATES

October Term, A. D. 1946 - - Number .....

In the Matter of the Estate of
EDNA N. WEIL,
Deceased.

— — — — — — — — — — —

RALPH N. WEIL,

Petitioner,

vs.

H. F. HAESSLER HARDWARE CO.,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, being aggrieved by the judgment and decree hereinafter mentioned, respectfully submits his petition for a writ of certiorari to review a judgment of the Supreme Court of the State of Wisconsin affirming a judgment of the County Court for Milwaukee County, Wisconsin, in the above entitled case.

SUMMARY STATEMENT OF MATTER INVOLVED.

The federal question involved in this proceeding is whether certain liabilities of the petitioner are discharged in bankruptcy.

This case arises out of the financial affairs of Hercules Construction Company, a Wisconsin corporation, which was engaged in the construction business between 1923 and 1929. Ralph N. Weil, petitioner herein, was the President of Hercules Construction Company. H. F. Haessler Hardware Company was a creditor of Hercules at the time Hercules ceased doing business.

Hercules was continually operating at a loss and, as was later found, was continually insolvent.

From 1925 to 1929, Ralph N. Weil drew salary as manager of Hercules. For 1925, he drew salary at a rate of Five Thousand ($5000.00) Dollars per year and from 1926 at an increased rate of Ten Thousand ($10,000.00) Dollars per year. (R. 147) The total sum drawn during the four and one half year period mentioned exceeded Forty Thousand ($40,00.00) Dollars. (R. 165)

While an officer of Hercules, Ralph N. Weil was also an officer and director of another corporation, Dorilton Arms Company. In 1925 Hercules entered into a contract to erect an apartment building for Dorilton Arms at a price of One Hundred Twenty-seven Thousand ($127,000.00) Dollars. Dorilton Arms paid all but Sixteen Thousand Eight Hundred ($16,800.00) Dollars of the contract price. On December 31, 1926, Ralph N. Weil caused an entry to be made on the books of Hercules crediting the account of Dorilton Arms with the unpaid balance of Sixteen Thousand Eight Hundred ($16,800.00) Dollars. Actually the balance of the money was never paid by Dorilton Arms nor received by Hercules. (R. 145)

In 1929, Haessler Hardware Company commenced an equitable action in the Circuit Court of Milwaukee County for the purpose of sequestering the assets of Hercules and for other relief in connection with a winding-up suit. (R. 185) A receiver was appointed. Subsequently, by supplemental complaint (R. 125-139) in the sequestration action, Haessler commenced suit on behalf of all creditors of Hercules, to recover from Ralph N. Weil and the other officers and directors of Hercules various sums alleged to have been lost through misfeasance and mismanagement of the directors. In 1933, a judgment of the Circuit Court of Milwaukee County was entered in that action in favor of Haessler (on behalf of all creditors) and against Weil adjudicating that Weil was liable to the creditors of Hercules in the sum of Sixteen Thousand Eight Hundred ($16,800.00) Dollars on account of the Dorilton Arms transaction. The Circuit Court of Milwaukee County further found that the salaries paid to Weil over the period above mentioned were excessive in the sum of Ten Thousand ($10,000.00) Dollars and rendered judgment on that account in favor of the creditors of Hercules and against Weil in the sum of Ten Thousand ($10,000.00) Dollars. (R. 170-178)

No part of this judgment was ever paid.

Thereafter Ralph N. Weil filed a petition for adjudication in bankruptcy in the United States District Court for the Eastern District of Wisconsin and was duly adjudicated a bankrupt. (R. 121) He received his discharge in bankruptcy on April 28, 1934. (R. 123) All the Haessler judgments were scheduled in the bankruptcy. (R. 121)

Edna N. Weil, the mother of Ralph N. Weil, died May 1, 1945. Her estate is being administered in the County Court of Milwaukee County. Ralph N. Weil is her son and only heir at law and is a resident of New York. (R. 101) In 1945 H. F. Haessler Hardware Company filed its

petition to intervene in the proceedings in County Court for the purpose of intercepting the distributive share of Ralph N. Weil in his mother's estate and applying the same toward the satisfaction of the aforementioned Circuit Court judgment. (R. 101) Weil pleaded his discharge in bankruptcy in opposition to the petition. (R. 105-106) The County Court of Milwaukee County, in which the matter was tried, ruled that the liabilities above mentioned were not discharged in bankruptcy (R. 109, R. 116) and entered a judgment directing the payment of Ralph N. Weil's distributive share to apply on the Haessler judgment. (R. 118)

An appeal was taken to the Supreme Court of the State of Wisconsin which rendered a decision affirming the judgment of the County Court. (R. 194) Motion for rehearing was denied December 23, 1946. (R. 206)

QUESTIONS PRESENTED.

1. Does Section 17a (4) of the Bankruptcy Act except from the operation of a discharge in bankruptcy a liability claimed to exist from the sole act of a corporate officer in making certain entries on the books of a corporation where the entries are not the effective cause of a loss of assets of the corporation?

2. Does Section 17a (4) of the Bankruptcy Act except from the operation of a discharge in bankruptcy a liability created by reason of a corporate officer's drawing salaries in the regular course of business which salaries are subsequently determined to be in excess of what the officer's services were reasonably worth?

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

The State Court has decided a federal question of substance not heretofore determined by the Supreme Court of the United States. The State Court has decided the federal question in a way probably not in accord with analogous decisions of the United States Supreme Court.

1. The present case is somewhat unusual in that the liability of Ralph N. Weil for Sixteen Thousand Eight Hundred ($16,800.00) Dollars by reason of the transaction with Dorilton Arms Company did not arise out of the conversion of any assets by Weil; it arose by reason of the fact that Weil made certain bookkeeping entries on the books of Hercules Construction Company. The account in question was never actually paid. It could have been enforced by suit brought by Hercules or its receiver against Dorilton Arms. The Circuit Court based its original finding of liability on the theory that the making of the bookkeeping entry constituted a waiver of Hercules' right to recover this sum from Dorilton Arms (R. 145); however, calling it a waiver does not change the basic facts involved. No period of statutory limitations was operative to bar the corporation from disregarding it. Such a waiver could not bind Hercules, for it was without consideration. Dorilton Arms' liability to Hercules could not be destroyed by such a "waiver". Thus, even after the making of the entries, and even after the discovery thereof by the creditors, the liability of Dorilton Arms to Hercules still existed and could be enforced.

In all of the cases which we have examined concerning the effect of Section 17a (4) of the Bankruptcy Act where a liability was not discharged there has been some defined asset of the corporation converted, embezzled or destroyed

by the defaulting officer, and it was the conversion or destruction of that defined asset which formed the basis of the officer's liability to the corporation. Such liabilities have been held non-dischargeable. We have found no case wherein a non-dischargeable liability was created without some act being done which resulted in the destruction or loss of defined assets to the corporation. The present case goes beyond any case which has ever been decided by any court in holding such a liability as here involved which was created without reference to the loss of assets to the corporation, to be a non-dischargeable liability.

It is submitted that Section 17a (4) of the Bankruptcy Act will not bar a discharge where a claim of misfeasance by a corporate officer is involved, unless the officer's act creates a real loss to his corporation. In the present case, it was not the act of Weil in making the bookkeeping entries which created a loss. If a loss occurred it was created by the failure of the receiver to take available and effective steps against Dorilton Arms to enforce a known and enforceable liability. Hence, Section 17a (4) of the Bankruptcy Act is not applicable to this liability.

2. The liability for repayment of Ten Thousand ($10,000.00) Dollars was adjudicated by reason of the fact that the salaries paid to Ralph N. Weil over a four and one-half year period were excessive. The Circuit Court in the sequestration suit found that the amount of the excess was at least Ten Thousand ($10,000.00) Dollars over what his services were reasonably worth in this period. The effect of the present ruling in this case is to hold that this liability is not dischargeable in bankruptcy.

All the decisions, until the recent Michigan case of *Citizens Mutual Automobile Insurance Co. vs. Gardner*, 24 N. W. (2d) 410, decided October 7, 1946, uniformly held

that all the liabilities created by an officer's fraud, embezzlement, misappropriation or defalcation, involved an element of moral turpitude or bad faith and that before a liability will be held non-dischargeable under this subsection that element must be established.

In our case, petitioner drew total salaries from 1925 to 1929 in excess of Forty Thousand ($40,000.00) Dollars. Of this sum the trial court found that Ten Thousand ($10,000.00) Dollars was in excess of the reasonable value of his services. This sum was not drawn in one lump payment or secretly but was drawn openly in the normal course of business over the four and one-half year period mentioned; this negatives the inference that there was any plan or design involving wrongful intent or a raid on company funds. Inherently these facts negative any element of moral turpitude. Despite the strong language of the findings, the most that the facts establish is that Weil received a higher salary than the company could afford to pay by 25%.

We have found no case under Section 17a (4) in which a liability of a corporate officer was declared non-dischargeable when it arose out of his drawing of salaries in the regular course of business. The interpretation of Section 17a (4) adopted by the Wisconsin Court in the instant case which makes such a liability non-dischargeable is not only a new interpretation which has never been adopted by any other court but is contrary to the holding of analogous decisions of the U. S. Supreme Court, particularly the cases of *Neal vs. Clark*, 95 U. S. 704 and *Davis vs. Aetna Acceptance Company*, 293 U. S. 328.

It is noted that in the instant case, the Supreme Court of Wisconsin did not define the liability in question so that it would fall into any one of the specific four categories exempted from discharge by Section 17a (4) i.e., a fraud, an embezzlement, a misappropriation or a defal-

cation. None of the four words used in 17a (4) can be construed to cover the drawing of salaries in the regular course of business. Since the liability is not specifically excepted from the operation of a discharge under any of the four classifications contained in Section 17a (4), the discharge in bankruptcy should bar the liability.

It is true that there are in the record formal findings of the Circuit Court which tried the case in 1933 which characterize the liabilities in question as liabilities created by fraud. However, the rule in Wisconsin is that in order to determine whether the liability is excepted from the operation of a discharge, the court may look behind the judgment and formal findings and consider the entire record and the actual facts disclosed thereby as the basis for the liability will govern. This rule permits the Court to go back of the findings and consider the actual facts.

It is submitted that on the facts as disclosed in the record herein, the Supreme Court of Wisconsin has adopted an erroneous interpretation of Section 17a (4) of the Bankruptcy Act in that the language of the act, which excepts from the operation of a discharge, liability created by fraud, embezzlement, misappropriation or defalcation by an officer, has never been construed and should not be construed to except from the operation of a discharge in bankruptcy liabilities such as those involved in the instant case.

Wherefore your petitioner respectfully prays that a writ of certiorari issue under the seal of this court to review the judgment of the Supreme Court of the State of Wisconsin in the above case and that said judgment be reversed.

EMIL HERSH,
Attorney for Petitioner.

SUMMARY OF ARGUMENT.

Summary of Argument—*Continued.*

Summary of Argument—*Continued.*

In The

SUPREME COURT OF THE UNITED STATES

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In the Matter of the Estate of
EDNA N. WEIL,
Deceased.

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RALPH N. WEIL,

Appellant,

vs.

H. F. HAESSLER HARDWARE CO.,

Respondent.

BRIEF IN SUPPORT OF PETITION.

OPINIONS BELOW.

There was no officially reported opinion in the County Court of Milwaukee County; however, the written decision of the trial court appears at Page 107 of the record.

The opinion of the Supreme Court of the State of Wisconsin is reported in Vol. 249 Wisconsin Reports (advance sheet) Page 385, 24 N. W. 2nd 662. (R. 195)

STATEMENT AS TO JURISDICTION.

The judgment of the Supreme Court of the State of Wisconsin sought to be reviewed was entered on October 22, 1946 (R. 194) Motion for rehearing was denied on December 18, 1946 (R. 206)

The jurisdiction of this court is invoked under Section 237(b) of the Judicial Code (U. S. Code, Title 28, Section 344(b)) on the ground that appellant specially claims a right, privilege or immunity under a statute of the United States, to-wit: the Bankruptcy Act.

STATEMENT OF FACTS.

The facts have been stated in the petition.

SPECIFICATION OF ERRORS.

It is submitted that the Supreme Court of the State of Wisconsin erred:

1. In holding that the liability of appellant for the sum of Sixteen Thousand Eight Hundred ($16, 800.00) Dollars was a debt "created by fraud, embezzlement, misappropriation or defalcation" as those terms are used in Section 17(a)(4) of the Bankruptcy Act, and in consequence that said liability was not discharged in bankruptcy.

2. In holding that appellant's liability for the sum of Ten Thousand ($10,000.00) Dollars was "created by fraud, embezzlement, misappropriation or defalcation" as those terms are used in Section 17(a)(4) of the Bankruptcy Act and that by reason thereof said liability was not dischargeable in bankruptcy.

3. In affirming the judgment of the County Court of Milwaukee County which directed appellant's distributive share in the estate of Edna N. Weil to be applied on the Haessler Hardware Company judgment.

Argument.

POINT I.

The Instant Case Involves the Construction of Section 17a (4) of the Bankruptcy Act.

Section 17a (4) of the Bankruptcy Act (11 U. S. C., Sec. 35) reads as follows so far as material here:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as * * * (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; * * * "

Originally there were four separate liabilities involved in the present case; One Thousand ($1000.00) Dollars, Four Hundred ($400.00) Dollars, Sixteen Thousand Eight Hundred ($16,800.00) Dollars and Ten Thousand ($10,000.00) Dollars. Questions relating to the dischargeability of the Thousand ($1000.00) Dollar and Four Hundred ($400.00) Dollar liabilities involved the construction of subsection 2 of Section 17a. We are not requesting review of these questions on this petition, since those questions involve conflicting inferences from the facts. The questions relating to the dischargeability of the liabilities for Sixteen Thousand Eight Hundred ($16,800.00) Dollars and Ten

Thousand ($10,000.00) Dollars involve only subsection 4 of Section 17a of the Bankruptcy Act.

In the present case, the Wisconsin Supreme Court based its decision on the proposition that (Record at Page 204)

> "Consequently, as appellant's indebtedness for said sums of $16,800.00 and $10,000.00 Dollars were liabilities created by his fraud and misappropriation while acting as an officer of Hercules, they are liabilities as to which, under the exception in the provision in Sec. 17(a)(4) of the Bankruptcy Act, no release was effected by his discharge in bankruptcy."

The issue presented is whether the Wisconsin Supreme Court correctly construed 17(a)(4) of the Bankruptcy Act as applicable to the facts in this case.

POINT II.

Section 17a (4) of the Bankruptcy Act Does Not Except a Corporate Officer's Debt From the Operation of a Discharge in Bankruptcy Unless the Corporation Has Lost Some Defined Asset Through the Officer's Misfesance.

It is not the purpose of this brief to review all of the cases construing Sec. 17a (4) of the Bankruptcy Act in order to demonstrate that the foregoing is a correct statement of the rule of law. If the Court grants certiorari, a more extended argument on this point will be made. In support of the petition for certiorari, the argument will be abbreviated.

The statute refers to "debts * * * *created* by his fraud etc." The debt exists because the corporation has been deprived of an asset. The use of the word "created" indi-

cates a causal relationship between the fraud, etc., and the loss of the asset. We have not found any case decided under Section 17a (4) where a claim arising out of misfeasance by a corporate officer was held non-dischargeable unless the misfeasance created a loss of some defined asset to the corporation.

The authorities cited by the Wisconsin Supreme Court in its opinion in connection with the application of Section 17a (4) to the case (R. pp. 204-205) exemplify the rule that an officer's misfeasance must create a loss of a defined asset to the corporation before Section 17a (4) lifts the bar of a bankruptcy discharge.

Thus in *Savin vs. McNeill*, 244 Wis. 552, 13 N. W. 2d 82, money was removed from the bank account of the corporation by the defaulting officer.

In *Matter of DeGraaf*, 22 Fed. 2d 163 the bankrupt took cash belonging to the corporation.

In *Matter of Metz*, 6 Fed. 2d 962, money was taken from the corporation's bank account.

In *Matter of Bernard*, 87 Fed. 2d 705, the officer took money from the corporation's account.

In *Matter of Hammond*, 98 Fed. 2d 703, an option to purchase stock, which was the property of the corporation, was exercised by the defaulting officers for their individual benefit thus depriving the corporation of the stock itself.

In *Bannon vs. Knauss*, 57 Ohio App. 288, 13 N. E. 2d 733, money was taken from the corporate treasury.

Harper vs. Rankin, 141 Fed. 626, involved embezzlement of the funds of a National Bank.

Bloemecke vs. Applegate, 271 Fed. 595, involved payment to an officer of corporate funds amounting to Eighteen Thousand Two Hundred Fifty ($18,250.00) Dollars, on an overstated claim for reimbursement for moneys advanced.

In *Matter of Gulick*, 186 Fed. 350 the ultimate question of dischargeability of an obligation was not determined,

although Judge Hand, then a District Judge, indicated that the extent to which a claim against a corporate officer would be non-dischargeable would be limited to the extent of corporate property actually misappropriated by him.

The above cases are cited as examples to show that the scope of the exception to a discharge contained in Section 17a (4) has never been extended to bar the discharge of a corporate officer's adjudicated liability unless the officer's misfeasance caused the loss of some defined asset of the corporation.

POINT III.

Appellant's Liability for Sixteen Thousand Eight Hundred ($16,800.00) Dollars Arose Out of a Transaction With Dorilton Arms Company. This Transaction Did Not Cause the Loss of Any Defined Asset of the Corporation.

Under Wisconsin law it is proper to go behind the formal findings and judgment to determine the facts upon which liability is predicated. It is those facts, and not merely formal recitals in the findings or judgment, which will determine the dischargeability of a claim in Bankruptcy. In its opinion in the present case the Wisconsin Supreme Court cited this rule. (Record Page 201)

Applying this rule and looking behind the judgment to determine the actual facts of the case, it becomes apparent that no defined asset of Hercules Construction Company was destroyed or affected in any way in the transaction out of which Weil's liability for Sixteen Thousand Eight Hundred ($16,800.00) Dollars was adjudicated.

That transaction was simply the making of an entry on the account books of Hercules Construction Company

purporting to credit an account receivable owing from Dorilton Arms with the sum of Sixteen Thousand Eight Hundred ($16,800.00) Dollars. The trial judge who originally tried the law suit in 1933 ruled that the making of the entry was a "waiver" of the account receivable. However, the basic facts involved remain unchanged by the use of such a descriptive term. Weil's physical act was the making of an entry on the books of the corporation. The question presently for decision is whether the making of such an entry by itself can possibly result in the creation of a non-dischargeable liability. Our contention is that since, by the making of such an entry, no asset of the corporation was affected, that any liability imposed by reason of the making of the entry is not included in Section 17a (4) and is therefore dischargeable.

It is noted that before the bookkeeping entry in question was made, Dorilton Arms owed Hercules Sixteen Thousand Eight Hundred ($16,800) Dollars. The making of an entry in the creditor's account book could not change the status of this obligation. After the entry Dorilton Arms still owed Hercules Sixteen Thousand Eight Hundred ($16,800.00) Dollars. No consideration having passed to Hercules or from Dorilton Arms, the liability was not discharged by the entry in question.

2 Restatement, Contracts, Sec. *406,* Page 765 et seq. *

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* 2 Restatement Contracts P. 765 (Bold Face Type supplied)

"§406. **Discharge of Duties by Agreement of the Parties.**

"Except in the case of contracts for the benefit of third persons an agreement by the parties to a contract to rescind their contractual duties, or duties to make compensation, discharges such duties **if the agreement is under seal, or is based on sufficient consideration,** or induces such a change of position as is

In its opinion, the Wisconsin Supreme Court says (Record Page 203)

"Consequently, in view of the facts thus found, appellant's liability for the sum of Sixteen Thou-

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stated in §90; but otherwise is operative only in cases within the rules stated in §§410-416.

Comment:

"a. Save in the exceptional cases stated in §§410-416, consideration or a seal is as essential for the discharge of either a contractual duty, or a duty to make compensation for breach of a contractual duty, as it is for the creation of a contractual right and duty. As the general rule is that a contractual right cannot be created without consideration or a sealed writing so also it is generally (though not universally) true that **a right created by contract cannot be extinguished by agreement without consideration or a sealed writing or some statutory equivalent * * ***

"c. Not only where the contract is unilateral, but also where it is bilateral and has been fully performed on one side since its formation, or **where a duty to make compensation has arisen with no reciprocal duty, a mutual agreement to rescind without more is ineffectual,** save in the exceptional cases stated in sections 410-416 (not material here) **since the creditor's agreement is unsupported by consideration. The question is not one of words but of substance.** Whether the parties talk of 'recission', 'release', 'discharge', **'waiver'** 'gift', or 'forgiveness' of the right is immaterial. As one party only was entitled to anything under the contract at the time of the attempted recission he alone undertakes to give up anything at the time of the discharge."

Illustration 2.

"A contracts to dig a ditch for B, for which B contracts to pay $100. A digs the ditch but later B's financial condition becomes impaired and A says, 'You need never pay me that $100 that you owe me.' The debt is still owing."

sand Eight Hundred ($16,800.00) Dollars was created by his fraud and misappropriation *of an asset* of Hercules while acting as an officer thereof."

It is respectfully submitted that *no asset was misappropriated in this case.* A formal finding of the original trial court that "the directors *disposed* of a debt due the Hercules Construction Company without consideration" is not a sufficient basis on which to hold that this liability was not discharged in bankruptcy. *The debt could not be disposed of by the act of making a book entry.* To so state is to state the impossible. The corporate asset was the account receivable, not the record of it in the books of account. The asset was not disposed of by the making of a book entry. It was as vital after the entry as it was before.

Moreover, no period of limitations operated to bar Hercules' right to collect the account receivable from Dorilton Arms. The contract between Hercules and Dorilton Arms was entered into June 3, 1925. (Record Page 162) The alleged allowance of Sixteen Thousand Eight Hundred ($16,800.00) Dollars was made December 31, 1926. (Record Page 162) The receiver was appointed October 9, 1929 (Record Page 185), and the supplemental complaint which shows a knowledge of the facts on the part of the receiver was filed March 24, 1931. (Record Page 124) The statute of limitations on simple contracts in Wisconsin is six years. (Wisconsin Statutes, Section 330.19) Thus it will be seen that the claim against Dorilton Arms by Hercules was not outlawed at the time the receiver commenced suit against Weil. And no attempt has ever been made to impose liability on Weil on any such ground.

The foregoing points are mentioned, not to obtain review of the 1933 judgment but to indicate that it was not the act of Ralph Weil in making the book entry which resulted in

the loss of the Dorilton Arms account receivable to Hercules Construction Company; it was the failure of the corporate receiver to sue Dorilton Arms on its unpaid contract liability which ultimately resulted in the loss to the corporation and its creditors. Weil's only act, the making of the book entry, becomes immaterial in determining the proximate cause of the loss of the corporate asset, since, in reality, the book entry itself did not affect any defined asset of Hercules Construction Company. Even though these facts impose liability under Wisconsin law, the liability thus imposed is dischargeable in bankruptcy under Federal law.

We contend that under these facts, Weil's adjudicated liability for Sixteen Thousand Eight Hundred ($16,800.00) Dollars is not a liability *created* by either a fraud, an embezzlement, a misappropriation or a defalcation; even though Weil fraudulently and in bad faith made a false entry on the books of Hercules, his act did not *create* the loss of a defined asset to Hercules; in the absence of such a loss, Section 17a (4) will not except the debt from the operation of a discharge in bankruptcy.

So far as we have been able to determine, the instant case is the first one ever decided in which it has been held that the act of a corporate officer in making a book entry creates a non-dischargeable liability under Section 17a (4) of the Bankruptcy Act, even though it can be demonstrated that the entry, in and of itself, could not possibly have caused loss of an asset to the corporation. An interpretation of Section 17a (4) of the Bankruptcy Act which extends it to cover such a situation is a new interpretation which raises a substantial question of Federal Law not heretofore determined by any other appellate court. The interpretation of Section 17a (4) of the Bankruptcy Act adopted by the Wisconsin Supreme Court in this case deserves review by the Supreme Court of the United States.

POINT IV.

Section 17a (4) of the Bankruptcy Act Does Not Except a Debt From the Operation of a Discharge in Bankruptcy Unless the Debt Was Created Under Circumstances Involving Moral Turpitude or Intentional Wrong Doing by the Debtor.

With respect to the Sixteen Thousand Eight Hundred ($16,800.00) Dollar liability we have stated our position that no asset was lost to the corporation by any act of Weil's. With respect to the Ten Thousand ($10,000.00) Dollar liability our position is that Weil's act in drawing this sum as salaries involved no moral turpitude or intentional wrong doing such as is necessary to prevent a discharge in bankruptcy.

It has long been the rule that an element of moral turpitude or intentional wrong doing is implied in each of the words, "fraud, embezzlement, misappropriation or defalcation" as used in Section 17a (4) of the Bankruptcy Act.

The word "fraud" was construed by the Supreme Court of the United States in *Neal vs. Clark*, 95 U. S. 704. In construing the same word as used in Section 33 of the Bankruptcy Act of 1867 (the direct lineal ancestor of Section 17a of the present act) the Supreme Court said,

> "The fraud referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong as does embezzlement, and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality. Such a construction of the statute is consonant with equity and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency. A different construction would

be inconsistent with the liberal spirit which pervades the entire bankrupt system."

It has been held that the same construction applies to the term "fraud" as used in the Bankruptcy Act of 1898, the present Bankruptcy Act. See *Western Union Cold Storage Co. vs. Hurd,* 116 Fed. 442 (CC-WD Missouri).

It will be noted that this construction of the term "fraud" was derived by applying the rule of *noscitur a sociis.* Since "embezzlement" connoted moral turpitude or intentional wrong doing, it was held that the word "fraud" also connoted moral turpitude or intentional wrong doing. The addition of the words "misappropriation" and "defalcation" in the same clause in Section 17a (4) indicates that since the words "fraud, embezzlement, misappropriation or defalcation" are *ejusdem generis* the rule of *Neal vs. Clark* applies; whether the liability is denominated a "fraud", an "embezzlement", a "misappropriation", or a "defalcation", there must be moral turpitude or intentional wrong doing in order to render the liability non-dischargeable under this subsection. Cf. *Matter of Bernard,* 87 Fed. 2d 705 (CCA 2d).

Analogous to the situation presented in this case although concededly not controlling is the interpretation adopted by the Supreme Court of the United States with reference to the definition of "willful and malicious injuries" as contained in Section 17a (2) of the Bankruptcy Act. It has been frequently held that a conversion for instance is not necessarily a willful and malicious injury in every case. We submit that the language used by Justice Cardozo in construing Section 17a (2) is equally applicable to the definition of "fraud, embezzlement, misappropriation or defalcation" as contained in Section 17a (4):

"There is no doubt that an act of conversion, if willful and malicious, is an injury to property with-

in the scope of this exception (Section 17a (2)). Such a case was *McIntyre vs. Kavanaugh*, 242 U. S. 138, • • • where the wrong was unexcused and wanton. But a willful and malicious injury does not follow as of course from every act of conversion, without reference to the circumstances. There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without willfulness or malice (citing cases). There may be an honest but mistaken belief, engendered by a course of dealing, that powers have been enlarged or incapacities removed. In these and like cases, what is done is a tort, but not a willful and malicious one."

Davis vs. Aetna Acceptance Co., 293 U. S. 328.

Extending the doctrine of this case one step further, there are cases, such as that part of the instant one involving the drawing of salaries, where what is done may be termed a "misappropriation or defalcation" but not one involving moral turpitude or intentional wrong doing. The liability should be dischargeable in bankruptcy.

The only case we have found which tends to hold to the contrary of the rule for which we contend is *Citizens Mutual Automobile Insurance Co. vs. Gardner*, 24 N. W. 2d 410, which was decided by the Supreme Court of Michigan on October 7, 1946. This decision was made after the argument but before the initial decision of our case in the Wisconsin Supreme Court and apparently was not published until after the Wisconsin Supreme Court had decided our case.

The Michigan case squarely holds that the term "defalcation" as used in Section 17a (4) of the Bankruptcy Act does not require the existence of moral turpitude or bad faith. Weil's liability for the repayment of Ten Thousand ($10,000.00) Dollars is not grounded upon a "defal-

cation"; in fact, the specific word in Section 17a (4) which applies to this branch of the case is not clearly defined although the Wisconsin Supreme Court seems to have held that Weil's acts constituted "misappropriation" of corporate assets. Thus, the Michigan case is not directly in point with ours. However, the Michigan case and the branch of our case with reference to the salary question are similar because neither involves moral turpitude or intentional wrong doing, as will later be seen.

In this respect both cases seem to run counter to the previously established rule that Section 17a (4) will not bar a discharge in the absence of moral turpitude or bad faith. It is respectfully submitted that the Supreme Court of the United States should reassert the rule of *Neal vs. Clark* with reference to the construction to be given to Section 17a (4) before the Michigan and Wisconsin cases create a substantial division of authority among other courts on the subject.

POINT V.

There Was No Moral Turpitude or Bad Faith Involved in the Drawing of Salaries Later Criticized as Excessive.

As far as we have been able to determine this is the first case in which the exception to a discharge set out in Section 17a (4) has been construed to include this fact situation. Looking behind the legal condemnation contained in the findings, the facts are that a corporate officer drew salaries in the regular course of business over a four and a half year period, ending in 1929. In 1933, a court finds that the salaries were in fact more than the corporation was able to pay in the exercise of sound business judgment. The Wisconsin Supreme Court now holds that the

original drawing of the salaries constituted a diversion of assets tainted with moral turpitude and so brings the liability under the interdiction of Section 17a (4).

It should be borne in mind that in the present case the trial court in 1933 found that the salaries drawn by Weil over the four and one-half year period from 1925 to the middle of 1929 were excessive by 25%—in other words he should have drawn One Hundred Fifty ($150.00) Dollars per week instead of Two Hundred ($200.00) Dollars per week. The court then finds that from the beginning of 1925 to the middle of 1929 the receipt of the extra Fifty ($50.00) Dollars a week by Weil as salary for services *then being rendered* in the operation of the corporation's business constituted a willful and malicious diversion of corporate assets charged with a high degree of moral turpitude. This is the only basis upon which the liability could be held non-dischargable.

The cases cited by the Supreme Court of Wisconsin in its opinion are of little help in determining the instant case. With one exception hereafter noted,* these were all cases in which corporate assets were withdrawn without consideration — clear cases of misappropriation of funds amounting to embezzlement. But in the present case assets were not withdrawn without consideration. The liability for the repayment of Ten Thousand ($10,000.00)

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* The exception is the case of **Matter of Bernard,** 87 Fed 2d 705 (CCA 2) in which a corporate officer having certain claims against the corporation used corporate assets to pay his own claims and those of his son in preference to other general creditors. The Circuit Court of Appeals for the Second Circuit held that this was a misappropriation of corporate funds and non-dischargeable under Section 17a (4). The holding was apparently based on a New York Statute which made the transfer of corporate assets in such a case a felony. We have no such statute in Wisconsin.

Dollars is based upon the drawing of salaries for services currently rendered in the regular course of business.

We contend that as a matter of law the drawing of salary by a corporate officer cannot later become the basis of a non-dischargeable liability. Salaries are necessarily fixed with reference to future operations as well as past experience. This is especially true in the present case. The salaries were fixed during a boom period, 1925 to 1929. The salaries were found to be excessive by a trial court sitting in the year 1933 and subject to depression psychology at its darkest period. It cannot reasonably be said under such circumstances that when the salary was fixed and drawn, the officer was impelled by motives involving moral turpitude.

The Circuit Court decision in the sequestration suit, that Ralph Weil was obligated to the creditors in the sum of Ten Thousand ($10,000.00) Dollars, was based on a finding that his salary over the four and one-half period mentioned was "in excess of what his services were reasonably worth." (Record Page 146) Of course, what any executive's services are reasonably worth is a matter as to which no line can be drawn. What is reasonable or unreasonable in the light of circumstances is a determination which lies within the boundaries of a broad field rather than on one side or another of a clearly defined point. What is a reasonable salary involves as much difference of opinion as what is a reasonable price or value. The effect of the holding in our case is that when a trial court's opinion as to what is a reasonable salary differs from the opinion of a corporate officer, the officer stands convicted of having misappropriated the difference between his opinion and the court's opinion. The misappropriation is then so charged with moral turpitude, that liability therefor cannot be discharged in bankruptcy. It seems unrealistic in the extreme that a trial court could

say in effect that $150.00 per week would be proper but that a salary of $200.00 is so grossly improper that to the extent of the extra $50.00 per week it was a misappropriation of corporate assets made in bad faith and charged with a high degree of moral turpitude.

We are not here arguing whether the salaries were or were not reasonable. That question was determined by the trial court in 1933 and we are not attempting to review that determination. *The question here is whether the liability was created by acts involving moral turpitude or intentional wrong doing so that the liability is not dischargeable in bankruptcy.* The distinction between the two questions may be said to be similar to the distinction in criminal law between a finding of probable cause and a finding of guilt. In our case the judgment in 1933 established a civil liability. The present question is whether that liability was also quasi-criminal in nature—that is whether it was charged with moral turpitude or intentional wrong doing so that it is not dischargeable in bankruptcy.

If the decision in the present case is sustained, an officer of a corporation must, at the first appearance of operating losses, continue to operate the corporation at his peril. If his efforts to salvage the corporation are unsuccessful, he runs the risk of having a court later determine the reasonableness of his salary during the period of operating losses, and if a court should determine that the salary was more than the corporation could afford, in light of its *then* condition, the officer becomes guilty of criminal misappropriation *ex post facto.* Who will attempt to save a failing corporation under such circumstances?

It is to be noted that in the decision in the Circuit Court in the sequestration action the Circuit Judge apparently had in mind the distinction between fraud in fact and im-

plied fraud or fraud in law which was given significance in *Neal vs. Clark.* Thus, in his discussion of the Dorilton Arms transaction he makes a clear finding (Record Page 145) that there was bad faith on the part of Weil and that the "waiver" of the $16,800.00 was fraudulent in fact. However, in the discussion of the salaries question (Record Page 146) he refers continually to the fact that the salaries paid to Weil were more than his services were reasonably worth and that his collection of such salary caused a depletion of assets which otherwise would have been available to creditors. The formal findings (Finding 42, Record Page 163; and Finding 49, Record Page 167) on these two items also illustrate the difference. The finding on the Sixteen Thousand Eight Hundred ($16,800.00) Dollars, was that Ralph Weil *"made said allowance fraudulently and* without a fair consideration and with intent to hinder, delay and defraud the creditors of the said Hercules Construction Company." The finding on the salary was that the salaries were *"withdrawn by said Ralph N. Weil* without a fair consideration and with intent to hinder, delay and defraud the creditors of said Hercules Construction Company."

The finding that the act was done to hinder, delay and defraud creditors is a finding of fraud in law not a finding of fraud in fact. The *fact* is that in the one case the alleged allowance of the Sixteen Thousand Eight Hundred ($16,800.00) Dollars was made with fraudulent intent and in the other that the salaries were paid without sufficient consideration. This is the very distinction between fraud in law and fraud in fact which was made by the Supreme Court of the United States in *Neal vs. Clark* and which we contend should be applied in this case. However, the distinction was not applied by the Wisconsin Supreme Court, both liabilities being treated identically.

Section 17a (4) has never been construed to exclude the drawing of corporate salary in the regular course of business from the operation of a discharge in bankruptcy. To so construe the statute, as the Wisconsin Supreme Court has done, is unwarranted. The construction adopted should be reviewed by this court.

CONCLUSION.

The present case involves the decision by the Supreme Court of Wisconsin of two Federal questions of substance relating to the correct interpretation of Section 17a (4) of the Bankruptcy Act. The clause to be construed is:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts whether allowable in full or in part except such as * * * (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer * * * "

We contend that implicit in this clause is the qualification that a liability will not be held non-dischargeable as a misfeasance by a corporate officer unless the misfeasance creates a loss of defined assets to the corporation. On that branch of the case where liability was imposed on Weil in the sum of Sixteen Thousand Eight Hundred ($16,800.00) Dollars by reason of the transaction between Hercules Construction Company and Dorilton Arms Company, the liability was imposed by reason of Weil's act in making certain book entries. These entries did not cause any loss of defined assets to the corporation; therefore the liability in question is not excepted from the operation of a discharge by Section 17a (4).

With respect to that branch of the case where liability was imposed on Weil in the sum of Ten Thousand ($10,000.00) Dollars by reason of excessive salaries we contend that the correct construction of Section 17a (4) requires

that in all cases under that section there must be a showing of moral turpitude or bad faith equivalent to criminal conduct before a liability will be held non-dischargeable. The drawing of salaries by a corporate officer over an extended period of time in the regular course of business can raise no implication of moral turpitude or bad faith. Hence Weil's liability for the repayment of Ten Thousand ($10,000.00) Dollars is not excepted from the operation of his discharge in bankruptcy under Section 17a (4).

Both branches of the case present questions which have never been determined by any other court of last resort. Although there are no cases directly in point the conclusion reached by the Supreme Court of Wisconsin is not in harmony with the analogous cases in the Supreme Court of the United States such as *Neal vs. Clark* and *Davis vs. Aetna Acceptance Company.*

For which reasons petitioner submits that a Writ of Certiorari should be granted.

Respectfully submitted,

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